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No.

IN THE

Supreme Court of the United States

MASTER FINANCIAL, INC.,
Petitioner,

vs.

STEPHEN and ROSEMARIE McDONALD,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

A. Was Master Financial's lien extinguished in violation of 11 U.S.C. §1322(b)(2) of the Bankruptcy Code ("Section 1322(b)(2)" herein)?

B. Was Master Financial's lien extinguished in violation of the United States Supreme Court decision of Nobelman v. American Savings Bank, 508 U.S. 324 (1993)?

C. Should Debtors be barred from extinguishing Master Financial's lien based on equitable and contractual considerations?

D. Is the Third Circuit Court of Appeals' Opinion fundamentally contrary to the holding of the United States Supreme Court's decision in Dewsnup v. Timm, 502 U.S. 410 (1992)?

CORPORATE DISCLOSURE STATEMENT

There are no publicly held companies that own 10% or more of Master Financial, Inc.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Master Financial Inc. ("Master Financial") respectfully prays that a writ of certiorari issue to review the Opinion of the United States Third Circuit Court of Appeals ("Circuit Court") dated March 9, 2000.

OPINIONS AND ORDERS BELOW

The March 9, 2000, Opinion of the Circuit Court reversing the judgment of the United States District Court for the Eastern District of Pennsylvania ("District Court") and remanding to the District Court, for it to remand to the United States Bankruptcy Court for the Eastern District of Pennsylvania ("Bankruptcy Court"), for further proceedings consistent with the Circuit Court's Opinion is reprinted as Appendix A hereto.

The Order of the District Court affirming the Order from the Bankruptcy Court is reprinted as Appendix B hereto.

The Opinion of the District Court is reprinted as Exhibit C hereto.

The Order of the Bankruptcy Court denying Debtors' Complaint is reprinted as Exhibit D hereto.

The Memorandum Opinion of the Bankruptcy Court is reprinted as Exhibit E hereto.

JURISDICTION OF THIS COURT

This is a Petition for Writ of Certiorari to the Circuit Court to review that Court's Opinion filed in

this case on March 9, 2000. A dispute currently exists between the Circuits of the United States and the decisions of the United States Supreme Court over proper treatment of junior mortgages secured by a debtor's principal residence in Chapter 13 bankruptcy plans.

Article III Section 2 of the United States Constitution states that "The judicial Power shall extend to all Cases, in Law and Equity, arising under ... the Laws of the United States ... ." This Petition for Writ of Certiorari seeks review of the Circuit Court's Opinion interpreting 11 U.S.C ("United States Bankruptcy Code") Section 1322(b)(2).

STATUTORY PROVISIONS INVOLVED

Article III Section 2, United States Constitution. The judicial Power shall extend to all Cases, in law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; - to all Cases affecting Ambassadors, other public Ministers and Consuls; - to all Cases of admiralty and maritime Jurisdiction; - to Controversies to which the United States shall be a Party; - to Controversies between two or more States; - between a State and Citizens of another State; - between Citizens of different States; - between Citizens of the same State claiming Lands under the Grants of different States, and between a State, or the Citizens theroef, and foreign States, Citizens or Subjects.

11 U.S.C. § 101(5) "claim" means - (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured

11 U.S.C. § 103(a) Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title.

11 U.S.C. § 103(h) Chapter 13 of this title applies only in a case under such chapter.

11 U.S.C. § 506(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 1322 (b)(2) Subject to subsections (a) and (c) of this section, the plan may - (1) ... (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

28 U.S.C. § 158(a)(1) The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders and decrees of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

28 U.S.C. § 158(d) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

28 U.S.C. § 1334(a). Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

BASIS OF FEDERAL JURISDICTION

The District Court has original jurisdiction of all cases arising under Title 11 in accordance with 28 U.S.C. § 1334(a). The Circuit Court had appellate

jurisdiction pursuant to 28 U.S.C. § 158(a)(1) and §158(d), from the final Order of the District Court entered on April 9, 1999, exercising appellate jurisdiction in affirming the Order of the Bankruptcy Court.

STATEMENT OF THE CASE

Stephen J. McDonald and Rosemarie J. McDonald ("Debtors" herein) filed a Chapter 13 Bankruptcy petition on December 3, 1997. Master Financial is the holder of a junior mortgage dated September 26, 1996, secured by Debtors' residence located at 2595 Ridge Road, Elverson, Pennsylvania ("Property" herein), in the original amount of $45,850.00.

Within that bankruptcy, Debtors filed an adversary proceeding ("Complaint" herein) in order to strip down Master Financial's mortgage upon the Property. Debtors alleged that the value of their home was $126,400.00, and the amount owed to the holder of the first mortgage was $127,633.33. No evidentiary hearing has been held regarding the value of the Property.

SUMMARY

Throughout this brief the term "strip down" shall refer to the process whereby a real estate mortgage lien secured by a debtor's principal residence is treated as wholly unsecured and thereby is extinguished as a lien against such real property. Master Financial's counsel recognizes that some

courts may at times refer to such a process as a "strip off," "lien strip" or "lien avoidance" action.

The term "mortgage" shall hereinafter refer to a claim secured by an interest in the real property that is the debtor's principal residence.

Debtors may not strip down or extinguish Master Financial's mortgage lien. Section 1322(b)(2) of the Bankruptcy Code ("Section 1322(b)(2)"), *In re Nobelman*, 508 U.S. 324, 113 S.Ct. 2106, and persuasive legal precedent clearly indicates that Master Financial's "rights" supersede the effect of property valuation under Section 506(a) of the Bankruptcy Code ("Section 506(a)").

The "rights" of Master Financial, pursuant to state law and mortgage instruments, should not be undermined by misplaced reliance on opinions that look to § 506(a) for strip down support.

The teachings of *In re Dewsnup*, 502 U.S. 410; 112 S.Ct. 773 (1992), further compel reversal and support the conclusion that Master Financial's mortgage lien cannot be extinguished.

REASONS FOR GRANTING THE WRIT

I. INTRODUCTION

"Some cases scream out for help from up above, i.e., either the Fifth Circuit or the Supreme Court. This is one of those cases." *In re Diggs*, 228 B.R. 611, 611 (Bankr. W.D. La. 1999). So began Bankruptcy Judge Schiff's analysis of Section 1322(b)(2) of the Bankruptcy Code. Mortgage lenders, Chapter 13 debtors and the Bankruptcy Courts urgently require

the guidance of the Supreme Court in these stripdown cases. There is a rift between the Circuits and the decisions of this United States Supreme Court as to the right of Chapter 13 debtors to avoid a wholly unsecured lien upon their principal residences.

II. MASTER FINANCIAL'S LIEN WAS EXTINGUISHED IN VIOLATION OF SECTION 1322(b)(2)

A. Legislative History and Intent Mandate Prohibition of Strip Down

Section 1322(b)(2) provides that a Chapter 13 Plan may "modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence...*" (emphasis added).

Master Financial's "claim" is indeed secured by a "security interest" in the subject Property.

Numerous courts have reviewed the legislative history relating to Section 1322(b) (2) and it is generally accepted that the underlying Congressional intent was to protect institutional lenders engaged in home mortgage financing.

As the Court noted in *In re Davis*, 989 F.2d 208, 210 (6th Cir. 1993):

> The *legislative history of the statute* [Section 1322 (b)(2)] indicates that it was designed *to protect and promote* "the increased production of homes and to encourage private individual ownership of homes as a traditional and important value in American life." *Federal Land*

Bank of Louisville v. Glenn (*In re Glenn*), 760 F.2d 1428, 1434 (6th Cir.), cert. denied, 474 U.S. 849, 106 S.Ct. 144; 88 L.Ed.2d 119 (1985). (emphasis added)

The purpose of Section 1322 (b)(2) is to provide stability in the residential home financing industry. *First Nat. Fidelity Corp. v. Perry*, 945 F.2d 61, 63-64 (3rd Cir. 1991); *In re Hart*, 923 F.2d 1410, 1412-13 (10th Cir. 1991); *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 242-36 (5th Cir. 1984 en banc); *In re Jackson*, 136 B.R. 797 (Bankr. N.D. Ill. 1992).

Section 1322(b)(2) *limits* the manner in which a proposed Chapter 13 Plan can deal with a secured residential lender's claim. *Matter of Graham*, 144 B.R. 80 (Bankr. N.D. Ind. 1992).

The court *In re Kacmarczyk*, 107 B.R. 200, 203 (Bankr. D. Neb. 1989) further details:

> "I conclude that § 1322(b)(2) continued the prohibition modifying the rights of holders of claims secured by real estate, but only with respect to real estate that constitutes the debtor's principal residence. *If Congress had intended to change the manner in which a claim secured by a debtor's residence would be treated under the code it would have specifically limited § 1322(b)(2) to claims secured pursuant to § 506.* However, as Congress did not explicitly change the treatment of claims secured by a mortgage on a debtor's residence, I conclude that a continuity of treatment of such claims was intended. (emphasis added)

In *Grubbs v. Houston First American Savings Association, supra,* 730 F.2d at 242-246, the Fifth Circuit discussed the legislative history of § 1322(b)(2). In its discussion, the court notes that the original House Bill (H.R. 8200) allowed a Chapter 13 Plan to modify any secured claim and that the Senate's version of the amended House Bill (S.B. 2266) prohibited modification of any claim secured by real estate. The ultimate provision was a reconciliation and compromise of the relative positions of the House and the Senate. The court concluded, *supra,* 730 F.2d page 246:

> [T]he Senate receded from its position that no "modification" was to be permitted of any mortgage secured by real estate; it instead agreed to a provision that *modification was to be barred only as to a claim "secured only by an interest in real property that is the debtor's principal residence."* This limited bar was apparently in response to perceptions ... that, *home-mortgagor lenders, performing a valuable social service through their loans, needed special projection against modification thereof* (i.e., reducing installment payments, secured valuations, etc.). (emphasis added)

Citing *Grubbs* with approval, the court in *In re Neverla,* 194 B.R. 547, 550 (Bankr. W.D.N.Y. 1996) describes:

> "This legislative history indicates that the United States Congress, in response to the concerns of secured creditor

> advocates intended to provide a more favorable treatment of residential mortgagees than to the holders of security interests in other assets of a Chapter 13 debtor. *As a result, Section 1322(b)(2) prevents the modification of the rights of a holder of a Homestead Mortgage, including the right not to have the amount of the Homestead Mortgagee's secured claim reduced by the use of Section 506(a)* to the fair market value of the collateral. As Justice Stevens noted in his concurring opinion in *Nobelman v. American Savings Bank* this "favorable treatment of residential mortgagees was intended to *encourage the flow of capital into the home lending market.*" *Nobelman*, 508 U.S. at 332, 113 S.Ct. at 2112 (emphasis added).

See also, In re Fraize, 208 B.R. 311 (Bankr. D.N.H. 1997).

Funds received in exchange for junior mortgages are frequently used for home improvements, down payments to senior lenders and the debt consolidation at lower interest rates. Often, first time home purchasers have insufficient funds for a large down payment and require junior mortgage financing to complete *the purchase*. Each of these ends also results in the flow of capital into the home lending market, the avowed purpose of Section 1322(b)(2). Additionally, mortgage lenders frequently deal in both senior and junior mortgages. Thus, protecting junior mortgages also protects senior mortgage holders.

The clear intent of the anti-modification provisions contained in Section 1322(b)(2) is to protect such mortgages and provide stability to the real estate financing industry, which includes junior and senior lenders.

B. The Proper Statutory Interpretation Requires Prohibition of Strip Down

The critical issue is whether Section 1322(b)(2) is specifically limited to protection of "secured" claims as defined by Section 506(a) or whether such language includes any "claims" that are secured only by a "security interest in the debtor's principal residence." Determining whether the ostensible protection afforded lenders under Section 1322(b)(2) applies to unsecured claims requires analysis of those two sections of the Bankruptcy Code. The conflict, if any, arises between the general definition section of Section 506(a) and the more specific Chapter 13 provision of Section 1322(b)(2).

Section 506(a) provides that an allowed claim secured by a lien on a debtor's property "is a secured claim *to the extent of the value* of such creditor's interest in the estate's interest in such property." (emphasis added)

Debtors contend that Section 506(a) operates automatically to adjust downward the amount of the claim to *zero* thereby making it wholly unsecured and outside of the protection of Section 1322(b)(2). Section 506(a) applies to Chapter 13 proceedings under the provisions of Section 103(a) of the Bankruptcy Code.

Under Section 103(h) of the Bankruptcy Code "Chapter 13 of this title applies only in a case under such chapter." Therefore, Section 1322(b)(2) specifically applies only to Chapter 13 cases.

Many courts have held that the *general* language of Section 506(a) does not prevail over the specific language of Section 1322(b)(2). *In re Schum*, 112 Bankr. 159 (Bankr. N.D. Tex. 1990); *In re Kacmarczyk, supra*; *In re Russell*, 93 B.R. 703, 705. *See also, In re Catlin*, 81 B.R. 522 (Bankr. D.Minn. 1987); *In re Hemsing*, 75 B.R. 689 (Bankr. D.Mont. 1987); *In re Hynson*, 66 B.R. 246 (Bankr. D.N.J. 1986). These courts adopt the long-standing proposition that rules of statutory construction or interpretation require that in the event of conflict, the general provision must give way to the specific statutory enactment. *D. Ginsberg & Sons v. Popkin*, 285 U.S. 204, 52 S.Ct. 322 (1932); *In re Brown*, 329 F. Supp. 422 (S.D. Iowa 1971).

In this instance, since Section 506(a) is a general provision that deals with multiple bankruptcy chapters (e.g. chapters 7, 11, 12 and 13) and Section 1322 (b)(2) deals only with Chapter 13 proceedings, Section 1322(b)(2) should be the controlling statute.

In the case of *In re Russell, supra*, 93 B.R. at 705, the court elaborates:

> When two statutes conflict ... a generally accepted tenet of statutory construction provides that regardless of the inclusiveness of the general language of a statute, *it does not apply or prevail over matters specifically dealt with in another part of the same enactment. See, Maiatico v. United States*, 302 F.2d 880,

886 (D.C. Cir. 1962); *In re Brown*, 329 F. Supp. 422, 425 (S.D. Iowa 1971). *This court accepts this tenet. Therefore, the specific language of § 1322(b)(2) would prevail over the general application language of § 506.* (emphasis added)

As further noted by the court in *In re Catlin, supra*, 81 B.R. at 524:

> Accordingly, in a Chapter 13 case, *the allowed amount of a claim secured only by a security interest in a principal residence of a debtor is*, at filing, the balance owing on the debt *without regard to the value of the collateral* -- § 506(a) notwithstanding. *Application of § 506(a)*, where the value of the collateral is less than the debt, would modify the rights of the holder of a claim secured only a security interest in the principal residence of a Debtor *beyond* the permissible impairment provided in § 1322(b)(2) and (5). (emphasis added)

Proper statutory interpretation clearly should not allow a valuation under Section 506(a) to control the specific exception against modification of Master Financial's claim under Section 1322(b)(2).

C. The Plain and Functional Reading of Section 1322(b)(2) Prohibits Strip Down

The anti-modification phrase within Section 1322(b)(2) does not use the term "secured claim" but

specifically refers to a "claim secured by" the debtor's principal residence.

The Court in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1031 (1989), held that:

> [T]he plain meaning of legislation should be conclusive, *except* in the "rare cases [in which] *the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.* In such cases intention of the drafters, rather than strict language, controls. (emphasis added)

This Court in *Nobelman, supra*, 508 U.S. at 311; 113 S.Ct. at 2111 explains:

> Congress chose to use the phrase "claim secured.... by" in § 1322(b)(2)'s exception, *rather than repeating the term of art "secured claim".* The unqualified word "claim" is broadly defined under the Code to encompass any "right to payment, whether ... secure[d] or unsecured" or any "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether ... secure[d] or unsecured." 11 U.S.C. § 101(5) (1988 Ed., Supp. III) (emphasis added)

As noted by the court in *In re Shandrew*, 210 B.R. 829, 831 (Bankr. E.D. Cal. 1997), citing *Nobelman*, the term "secured by" a debtor's residence "is not defined or limited by Section 506(a) but by applicable state law and the underlying security documents."

In *Shandrew*, the court, *supra* at 210 B.R. 831, describes the "rule of the last antecedent":

> The debtor argues that the absence of a "secured claim": prevents section 1322(b)(2) from coming into play. Put differently, the "anti-modification portion" of section 1322(b)(2) (a claim secured only by a security interest in real property that is the debtor's principal residence [may not be modified]) has no applicability because the perambulator language of section 1322(b)(2) ("the plan may ... modify rights of holders of secured claims...") assumes a secured claim as determined by section 506(a). *This is the so-called "rule of the last antecedent" discussed and rejected* in *Nobelman*. *Nobelman v. American Savings Bank* 508 U.S. at 330, 113 S.Ct. At 2111, 124 L.ED.2d at 236. (emphasis added)

The court in *In re Neverla*, 194 B.R. 547, 550 (Bankr. W.D.N.Y. 1996) citing *Nobelman* emphasizes:

> Furthermore, the *Supreme Court specifically rejected the rule of the last antecedent" and rejected an interpretation of Section 1322(b)(2) which would protect only a Section 506(a) "secured claim" of a holder* of a Homestead Mortgage. *Nobelman*, 508 U.S. at 330, 113. S.Ct. at 2110.
>
> I believe that *the Nobelman decision requires a functional reading* of Section

> 1322(b) and the conclusion that its *protection* is afforded *to all properly perfected holders* of Homestead Mortgages. This is because such properly perfected Mortgagees are literally "secured only by a security interest in real property that is the debtor's principal residence", [footnote omitted], *irrespective of whether they are wholly, partially, or totally unsecured after the application of Section 506(a).* This literal and functional interpretation is *consistent with the emphasis* in the *Nobelman* decision *on the state law contractual rights bargained for by the mortgagor and mortgagee and with the legislative history* which indicates that the subsection was intended to encourage the flow of capital into the home lending market and to exempt such mortgages from valuations and bifurcation as the result of an application of Section 506(a). (emphasis added)

In re Fraize, supra, 208 B.R. at 313, expands the "plain meaning" interpretation of Section 1322 (b)(2) and supports Master Financial's position:

> The language could have easily said, "except for a secured ..." *but instead refers to [a] "a claim secured only by security interest in real property."* It follows *that Congress intended to except the "claim"* held by the mortgagee *from modification, whether secured in accordance*

> *with a section 506 valuation or not*, as long as the claimant held a mortgage on the debtor's primary residence. The term "secured claim" is used throughout the Code, *but the draftsmen in this instance chose not to use it.* (emphasis added)

The functional and literal reading of Section 1322(b)(2), in light of *Nobelman* - and its legislative history, requires the conclusion that Master Financial's claim cannot be modified by Debtors' Chapter 13 Plan. *In re Tanner*, 223 B.R. 379, 382 (Bankr. M.D. Fla. 1998) is also supportive by detailing:

> *Nobelman and § 1322(b)(2) do not allow the Debtor to strip off* [a] mortgage lien. The *plain meaning* of § 1322(b)(2) prohibiting modification of "a claim secured only by a security interest in real property" *shows Congress's intent to except the "claim" from modification.* The language could have easily said, "except for a secured claim..." but instead refers to a "claim." (emphasis added)

The tortured reading of the interplay between Sections 506(a) and 1322(b)(2), as set forth in those cases cited in the Circuit Court's Opinion (e.g., *In re Lam*, 211 B.R. 36 (9th Cir. BAP 1997), appeal dismissed, 192 F.3d 1309 (9th Cir. 1999); *In re Plouffe*, 157 B.R. 198 (Bankr. D. Conn. 1993); *In re Hornes*, 160 B.R. 709 (Bankr. D.Conn. 1993) and *In re Sette*, 164 B.R. 453 (Bankr. E.D.N.Y. 1994), improperly ignores the plain and functional meaning of Section 1322 (b)(2).

None of those above-cited cases can point to a result where the above discussed literal application

"will produce a result demonstrably at odds" with the intentions of the Section 1322(b)(2) drafters. *United States v. Ron Pair Enterprises, supra,* 489 U.S. at 242, 109 S.Ct. at 1031.

III. SUPREME COURT DECISION OF IN RE *NOBELMAN* PROHIBITS STRIP DOWN OF MASTER FINANCIAL'S LIEN

A. Master Financial's Mortgage Rights Control Over Valuation of the Property

The *Nobelman* decision focused on the sanctity of real estate lenders' rights - not the value of its collateral. Any misguided reliance on *Nobelman* dicta regarding references to § 506(a) is quite incorrect. *Nobelman, supra,* 508 U.S. at 328-329, 113 S.Ct. 2109-2110.

The Circuit Court's Opinion, which seeks to invoke a Section 506(a) valuation as a prerequisite to the protections afforded under Section 1322(b)(2) is mortally defective. The Court explains in *In re Nobelman, supra,* at 508 U.S. at 328; 113 S.Ct. at 2109-2110:

> This interpretation fails to take adequate account of §1322(b)(2)'s *focus on "rights."* That provision does not state that a plan may modify "claims" or that the plan my not modify "a claim secured only by" a home mortgage. *Rather, it focuses on the modification of the "rights of holders" of such claims.* By virtue of its mortgage contract with petitioners, the bank is

> indisputably the holder of a claim secured by a lien on petitioners' home. (emphasis added)

This Court summarizes, *supra*, 508 U.S. at 332, 113 S.Ct. at 2111:

> [T]o give effect to § 506(a)'s valuation and bifurcation of secured claims through a Chapter 13 plan in the manner petitioners propose *would require a modification of the rights* of the holder of the security interest. *Section 1322(b)(2) prohibits such a modification* where ... the lender's claim is secured only by a lien on the debtor's principal residence. (emphasis added)

Among those "rights" which cannot be modified under Section 1322(b)(2), this Court includes "the right to retain the lien until the debt is paid off " and "the right to proceed against petitioners [debtors] residence by foreclosure" *Nobelman, supra*, 508 U.S. at 329, 113 S.Ct. at 2110. These are the "rights" bargained for by the mortgagor and mortgagee. *Dewsnup v. Timm*, 502 U.S. 410, 417; 112 S.Ct. 773, 778 (1992); *In re Neverla, supra*, 194 B.R. at 550.

The emphasis *Nobelman* placed on the "rights" of the residential lender cannot be ignored. The court in *In re Jones*, 210 B.R. 371 (Bankr. D.N.J. 1996) establishes firmly that:

> [I]t is *the existence* of a [home] *mortgage lien* which determines the applicability of § 1322(b)(2), and *not the value* of the collateral subject to that lien. (emphasis added)

See also, In re Tanner, 223 B.R. 379, 382 (Bankr. M.D. Fla. 1998); In re Shandrew, *supra*, 210 B.R. at 831.

There is no dispute that Master Financial has a perfected mortgage on Debtors' Property and that Master Financial's claim is subject to all the attendant "rights" described in *Nobelman* and its progeny.

B. Persuasive Legal Precedent Clearly Supports Master Financial's Position

In discussing strip down cases, the court in *In re Barnes, supra*, 207 B.R. at 592 pronounces:

> Instead of looking to rights granted by § 1322(b)(2), the opinions in these cases looked first to § 506(a) for valuation of the creditor's claim ... the opinions sanctioned stripoffs of the junior mortgages by *pointing to dicta in Nobelman* that stated "even if we accept petitioners' valuation, the bank is still the 'holder' of a 'secured claim,' because petitioners' home retains $23,500 of value as collateral." *Nobelman*, 508 U.S. at 329, 113 S.Ct. at 2110. (emphasis added)

The *Barnes* court, *supra*, 207 B.R. at 592, best describes the fallacy of such an approach by stating:

> Indeed, those dicta-based holdings allowing the "strip off" recreated the loophole *Nobelman* attempted to close and *misread Nobelman's focus on the rights* of secured creditors with security interest only in the debtor's principal

residence. *In re Jones*, 201 B.R. at 373, 374. (emphasis added)

Rather than relying on the dicta in *Nobelman*, courts have convincingly held that a proper reading of that opinion was an endorsement of creditors' rights as they were defined by state law and mortgage contract – *not valuation* of the real property.

This proposition is once again detailed in *In re Barnes, supra*, 207 B.R. at 592:

> A court analyzing a "stripoff" situation in Chapter 13, therefore, *should look first to whether the creditor holds a mortgage secured only by the debtor's principal residence.* If so, the creditor's rights under § 1322(b)(2) *may not be modified regardless of the presence or absence of underlying equity* in the residence, and there is no right to look to § 506(a) for valuation. A mortgage stripoff epitomizes a modification of creditor rights and *is not allowed* in Chapter 13 under § 1322(b)(2) and *Nobelman*. (emphasis added)

In *In re Perkins*, 237 B.R. 658, 660 (Bankr. S.D. Ohio 1999) the court holds:

> [T]*he better view, following the guidance given by* the Supreme Court in *Nobelman, focuses on the rights of the parties under their mortgage agreement, rather than a § 506(a) valuation,* to determine § 1322(b)(2)'s applicability. In *Nobelman*, the Supreme Court *specifically rejected* the debtor's argument that a § 506(a)

> valuation should determine the extent a claim is protected under § 1322(b)(2). 508 U.S. at 328, 113 S.Ct. 2106.
>
> * * *
>
> Like other courts espousing this view, the court believes that the *Nobelman* decision *"requires a functional reading of Section 1322(b)* and the *conclusion that its protection is afforded to all properly perfected holders* of Homestead Mortgages." *Neverla*, 194 B.R. at 550. Logically extending the Supreme Court's focus on the bargain between the parties, the court holds that § 1322(b)(2) protects from *modification any claim secured only by a lien* on a debtor's principal residence enforceable under state law *whether or not that claim would be partially secured or wholly unsecured under § 506(a).* (emphasis added)

Those courts that have refused to strip down a home mortgage, even though there is no equity in the home, have undertaken the proper interpretation of Section 1322(b)(2) and analysis under the *Nobelman* decision. See also *In re Blanchard*, 241 B.R. 461 (Bankr. S.D. Cal. 1999); *In re Shandrew, supra; In re Diggs*, 228 B.R. 611 (Bankr. W.D. La. 1999); *In re Fraize, supra; In re Neverla, supra; In re Jones, supra; In re Barnes, supra.*

IV. THE EQUITABLE AND CONTRACTUAL CONSIDERATIONS BAR STRIP DOWN OF MASTER FINANCIAL'S LIEN

A. Equitable Principles Prohibit Strip Down

As several courts have discussed, the practical effect of a strip down may be to allow the debtor to improperly take advantage of an increase in the value of the subject real property during the course of the Chapter 13. *In re Dewsnup, supra; In re Barnes, supra.* Upon creation of the mortgage lien, the parties' contractual obligations are established, which include benefits and burdens.

Borrowers are able to purchase a home, add residential improvements or otherwise utilize the funds provided by the lender. Residential lenders are given a security interest in the real estate. Residential lenders' interest in the real estate and the level of their protection should not be limited by a judicial "snap shot" regarding valuation.

If there is no equity in the real estate and the residential lender exercises its right to foreclose, the lender may take the loss or elect to hold the property for future sale. In either event, it is the lender's right to make such a decision.

As the court described in *In re Barnes, supra,* 207 B.R. at 594:

> Until Congress chooses to limit § 1322(b)(2) in some way, *all mortgagees holding security interest in a debtor's principal residence receive protection against any modification of their rights,* and may receive increased economic *protection of their interest from growing real estate value over the three to five year life of the Plan.* Should that value rise,

> the creditor stands to benefit thereby, and the *debtor may not capture such increase in value* through a § 506(a) stripoff. (emphasis added).

It would be illogical and inequitable for this Court to support the proposition that but for a *penny's* worth of equity, Master Financial's junior mortgage lien may be eliminated. In *In re Barnes, supra,* 207 B.R. at 593, the court reasons:

> *Nobelman did not foster this absurd result* because that decision did not delineate that any level of equity protecting the secured creditors is required for § 1322(b)(2) protection. Instead *Nobelman* flatly held that "[s]ection 1322(b)(2) prohibits modification where, as here, the lender's claim is secured only by a lien on the debtor's principal residence." 508 U.S. at 332, 113 S.Ct. at 2111." (emphasis added)

The court in *In re Shandrew, supra,* 210 B.R. at 832, citing Keith M. Lundin, states:

> [I]f the ... [value of the] senior lien was $84,999, *Nobelman* dictates that ... [the junior] lien be treated as a fully secured claim because it is supported by one dollar of equity in the home. *But, if the debtor's gloss on Nobelman is correct,* and *value slips one cent below the amount of the senior lien, HFC's junior lien is eliminated entirely. In re Barnes,* 199 B.R. at 257. This court cannot ascribe:

> to Congress the odd intent to extend the antimodification protection in § 1322(b)(2) to residential mortgage holders with any toehold on the debtor's property and to *refuse that same protection where collateral values have shifted a peppercorn below the creditor's position.* The lien rights of either creditor under state law ... are typically *the same whether the mortgage holder is dollar above or dollar below* the allowed secured claim threshold. This reading of *Nobelman* puts an undeserved premium on valuation of residential real property - it assumes a degree of accuracy in the valuation process that is without foundation in reality.
> Keith M. Lundin, *Chapter 13 Bankruptcy*, § 4.46, p. 220 (2d Ed. 1996 Supp.). (emphasis added)

To allow such a strip down "cannot be the result anticipated by Congress." *In re Fraize, supra,* 208 B.R. at 313. *See also, In re Neverla, supra,* 194 B.R. at 552.

B. The Strip Down Violated Master Financial's Additional Rights Under *Nobelman*

As noted in *In re Shandrew, supra,* 210 B.R. at 832, citing Judge Lundin again:

> .... In the words of Judge Lundin:
> Under the law of most states, even a mortgage holder with little or *no value in the collateral* to support its debt *has a*

> *'right' to foreclose its lien and sell the property ... Nobelman* seems to protect even the right of an 'unsecured' mortgage holder to exercise all its 'rights' under the mortgage contract and under state law.
> Keith M. Lundin, *Chapter 13 Bankruptcy*, 4.46, p. 4-56 to 4-57 (2d Ed.)." (emphasis added)

In addition to the rights to collect payments and foreclose upon default, Master Financial has the contractual right to "advance" funds to senior lienholders to protect their security interest in the subject real property.

Paragraph 4 of Master Financial's Mortgage Deed provides in pertinent part:

> "Borrower shall promptly discharge any lien which has priority over this Security Instrument ... ."

Paragraph 7 of Master Financial's Mortgage Deed provides in pertinent part:

> "If Borrower fails to perform the covenants and agreements contained in this Security Instrument ... then Lender ... may do and pay for whatever is ... necessary to protect the value of the Property and Lender's rights in the Property."

Regardless of the prospect of a strip down, the contractual "rights" established by the mortgage instrument, under the *Nobelman* holding, should include the right of Master Financial to "advance"

sufficient funds to establish equity. The logical extension of *Nobelman* would therefore afford all junior lienholders protection from strip downs by simply electing to make such advances.

C. Strip Downs Promote Abusive Pre-Bankruptcy Planning

If Master Financial's mortgage can be treated as unsecured if not supported by equity, the court in *In re Neverla, supra,* 194 B.R. at 551, warns that:

> ... [D]ebtors may have an *incentive not to pay prior mortgages or other charges* which can become a lien on their residence until such time as these non-payments results in negative equity for a subordinate Homestead Mortgage (emphasis added).

Indeed, *Neverla* points to the fact that in *In re Hornes, supra,* a case allowing a Chapter 13 strip down, there would have been equity for the junior lienholder had the debtor paid even 52% of an outstanding Water Pollution Control Authority utility charge of $1,217.97 - thereby avoiding the strip down.

Section 1322(b)(2) cannot reasonably be interpreted to allow abusive pre-bankruptcy planning. See *In re Fraize, supra; In re Barnes, supra.*

Debtors alleged that there was a senior mortgage on the Property, which had a remaining principal balance of $127,633.33 and that the Property was worth $126,400.00. The arrears on the first deed of trust obligation totaled $3,671.27. The Debtors' failure

to make mortgage payments created any alleged negative equity at the time of their Chapter 13 filing.

If Debtors had made payments of only *34% of what was due the first trust deed lienholder,* Master Financial would have equity in the Property.

The Bankruptcy Court below has an independent duty to make a considered assessment that Debtors' strip down plan has been filed in good faith. *In re Warren,* 89 B.R. 87, 93 (9th Cir. BAP 1988).

V. SUPREME COURT DECISION OF IN RE *DEWSNUP* BARS STRIP DOWN OF MASTER FINANCIAL'S LIEN

In the case of *In re Dewsnup, supra,* this Court specifically determined that a debtor could not strip down a residential mortgage lien in a Chapter 7 case.

The Court notes, *supra,* 502 U.S. at 419; 112 S.Ct. at 779, that:

> In *Long v. Bullard,* 117 U.S. 617, 620-621, 6 S.Ct. 917, 918, 29 L.Ed. 1004 (1886), the Court held that a *discharge* in bankruptcy *does not release real estate of the debtor from the lien of a mortgage* created by him before the bankruptcy." (emphasis added)

The Court also explains that by freezing the residential lender's interest at a judicially determined value, the creditor would lose the benefit of any increase in value by the time of foreclosure. Such a result could result in a "windfall" to the debtor.

The Court further states, *In re Dewsnup, supra,* at 502 U.S. at 417; 112 S.Ct. at 778:

> [T]he *creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee.* The voidness language sensibly applies only to the security aspect of the lien and then only to the real deficiency in the security. *Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor* and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain. (emphasis added)

The *Dewsnup* findings and rationale is thoroughly consistent with the prohibition of a strip down of Master Financial's mortgage lien.

As in a Chapter 7, when a debtor obtains a discharge in a Chapter 13 (by completing the Chapter 13 plan), the debtor is no longer personally liable to the creditor. However, there is no justification for the proposition that the mortgage lien should be extinguished.

The long established concept that real estate liens survive bankruptcy must be applicable to both Chapter 7 and Chapter 13 cases. The *Dewsnup* rationale, and the obvious absence of statutory authority to the contrary, clearly supports the proposition that even in a Chapter 13 proceeding Master Financial's mortgage lien cannot be extinguished. *See, In re Shandrew, supra,* 210 B.R. at 832.

CONCLUSION

There is no dispute that Debtors mortgaged and pledged their principal residence to Master Financial for a loan. Once Master Financial's residential lien had been established, the rights and protections afforded Master Financial under Section 1322(b)(2) and *Nobelman* prohibited a strip down.

Debtors are precluded from stripping down all or a portion of Master Financial's mortgage lien claim even though the residence may have a value less than the claim.

Debtors' attempt to strip down Master Financial's lien finds no support in either Section 1322(b)(2) or *Nobelman*. With respect to any contemplated modification of a mortgage lenders claim against a debtor's principal residence in a Chapter 13, Section 1322(b)(2) *trumps* Section 506(a).

Based upon the foregoing, Master Financial respectfully urges the Court to review and reverse the decision of the United States Court of Appeals for the Third Circuit allowing avoidance of Master Financial's lien.

DATED: June 6, 2000

Respectfully submitted,

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MASTER FINANCIAL, INC.

APPENDIX A

Filed March 9, 2000

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 99-1381

IN RE: STEPHEN J. MCDONALD;
ROSEMARIE J. MCDONALD,

Debtors

STEPHEN J. MCDONALD;
ROSEMARIE J. MCDONALD

v.

MASTER FINANCIAL, INC.

FREDERICK L. REIGLE, ESQ.,
STANDING CHAPTER 13 TRUSTEE;
FREDERIC J. BAKER, ESQ.,
ASSISTANT U.S. TRUSTEE,

Trustees

Stephen J. McDonald;
Rosemarie J. McDonald,

Appellants

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 99-cv-00149)
District Judge: Honorable James T. Giles

Argued December 6, 1999

Before: SLOVITER, ROTH and COWEN, Circuit Judges

(Filed: March 9, 2000)

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OPINION OF THE COURT

COWEN, Circuit Judge.

In this appeal we must determine whether the so-called "antimodification provision" in 11 U.S.C. Section 1322(b)(2) applies to a second, wholly unsecured mortgage on a Chapter 13 debtor's home. In *Nobelman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106 (1993), the Supreme Court held that a Chapter 13 debtor who had a single mortgage with an outstanding balance greater than the value of the debtor's residence could not divide the mortgage, pursuant to 11 U.S.C. Section 506(a), into secured and unsecured parts and treat only the secured part as subject to the antimodification clause. According to *Nobelman*, the full outstanding balance of the mortgage is governed by the antimodification clause. Justice Thomas's opinion for the Court left unresolved, however, whether the antimodification clause applies to a second or junior mortgage if that mortgage is wholly unsecured by any remaining value in the residence.[1]

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[1] Note that the phrase "wholly unsecured" in this context carries a specific meaning. While the mortgage holder of course initially obtained a security interest in the debtor's residence and in that sense has a secured claim, the second mortgage is now deemed wholly unsecured in the sense that the value of the debtor's residence is less than the amount due to a first or senior mortgage holder, leaving no remaining value for the second mortgage. Thus, at a foreclosure sale the holder of the wholly unsecured second mortgage would receive nothing from the direct proceeds of the sale.

In interpreting *Nobelman* the Bankruptcy and District Courts both concluded that the second mortgage on the McDonalds' residence is subject to the antimodification clause, even if the value of their home is less than the outstanding balance of the first mortgage, leaving the second mortgage wholly unsecured. Because we conclude that this interpretation fails to take into account several strands of the Supreme Court's reasoning in *Nobelman*, we will reverse.

I

Before reaching when the antimodification clause applies, we must address a question about our jurisdiction. In the Bankruptcy Court the parties purportedly entered into a stipulation of facts specifying that the outstanding balance of the first mortgage is greater than the value of the McDonalds' home. At oral argument before this court, however, Master Financial, the appellee and holder of the second mortgage on the McDonalds' home, asserted that their "stipulation" is not binding. On Master Financial's view if the Bankruptcy Court had held that the antimodification provision does not apply to wholly unsecured mortgages, then Master Financial would have contested whether the value of the home was indeed less than the outstanding balance of the first mortgage. Master Financial's interpretation of the "stipulation" apparently captured the Bankruptcy

Court's understanding of the case, for that Court's opinion simply noted that Master Financial disputed the value of the home and stated that no evidentiary hearing had been held on the issue. Thus, as matters stand, we can only say that the McDonalds have alleged that the value of their home is $126,400, the balance of the first mortgage is $127,633.33, and the balance of the second is $46,846.42.

In light of Master Financial's disavowal of any binding stipulation, we raised the issue of whether the bankruptcy court's decision amounted to an advisory opinion and consequently whether we have jurisdiction to hear this appeal. Federal courts are not authorized to issue advisory opinions. See, e.g., *United States Nat'l Bank v. Independent Ins. Agents of America, Inc.*, 508 U.S. 439, 446, 113 S.Ct. 2173, 2178 (1993); *Coffin v. Malvern Federal Savings Bank*, 90 F.3d 851 (3d Cir. 1996).

The precise analytical contours of what constitutes an advisory opinion, however, are less than clear. For example, Fed.R.Civ.P. 12(b)(6) allows a court to resolve certain legal disputes in advance of factual disputes. Even though allowing discovery and conducting a hearing on the facts could have provided an alternative, and perhaps in some sense narrower, ground for resolving the suit, a court can still consider a legal issue that, if decided in the defendant's favor, would be dispositive on a motion to dismiss. Doing so conserves both the court's and

the parties' resources. In keeping with this logic we appreciate that in the context of a Chapter 13 bankruptcy involving comparatively small sums of money, the parties understandably wanted to avoid expenses, such as the cost of expert testimony, that would have been incurred contesting the value of the home if in the end the evidence produced would be legally irrelevant. While the record is not entirely clear, we conclude that this case was decided on a motion to dismiss, notwithstanding the parties' odd references to a nonbonding stipulation of facts. The Bankruptcy Court's opinion accepted as true the McDonalds' allegations that the second mortgage was wholly unsecured and still held as a matter of law that the debtors must lose their adversary proceeding. Under these circumstances, it is clear that the Bankruptcy Court's interpretation of *Nobelman* conclusively resolved the litigation and did so without improperly issuing an advisory opinion.

Accordingly, we conclude that we are authorized to hear this appeal. We have jurisdiction pursuant to 28 U.S.C. Section 158(d), and since we are presented with a purely legal issue, we exercise plenary review over the District Court's determination, a determination that in turn resulted from a plenary review of the Bankruptcy Court's conclusions of law. *See, e.g., In re Anes*, 195 F.3d 177, 180 (3d Cir. 1999).

II

Our analysis of the merits of this appeal begins with two provisions of the bankruptcy code. The first, 11 U.S.C. Section 506(a), applies to bankruptcies under all chapters, see 11 U.S.C. Section 103(a), and sorts creditors' allowed claims against the debtor into secured and unsecured claims. Under Section 506(a) any allowed claim that is secured by a lien on the debtor's property "is a secured claim to the extent of the value of [the] creditor's interest in the estate's interest in such property," and is deemed an unsecured claim to the extent it exceeds that value. An undersecured claim is thus treated as a secured claim only up to the value of the collateral; the excess debt becomes an unsecured claim. The second relevant provision, the antimodification clause, applies only to Chapter 13 bankruptcies. The antimodification clause states that a Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence. . . ." 11 U.S.C. Section 1322(b)(2). Put more directly, the antimodification clause bars a debtor from modifying the rights of a creditor who has a claim secured only by the debtor's principal residence.

Before *Nobelman* some courts had concluded that in a Chapter 13 bankruptcy they should look first to Section 506(a) to determine both the value of a debtor's residence and how much of the mortgage remained secured. The courts would then treat only

the portion deemed secured under Section 506(a) as subject to the antimodification provision in Section 1322(b)(2). *See, e.g., In re Bellamy*, 962 F.2d 176 (2d Cir. 1992); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990); and *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989). Other courts, by contrast, concluded that there was a conflict between Section 506(a) and Section 1322(b)(2) and decided that Section 1322(b)(2) should prevail as the more specific provision. *See, e.g., In re Nobleman*, 968 F.2d 483 (5th Cir. 1992).

In reviewing the Fifth Circuit opinion, the Supreme Court agreed that Section 1322(b)(2) applies to both the part of a mortgage that is currently secured by value in the residence and the part that is unsecured, but significantly the Court nevertheless rejected the Fifth Circuit's position that Section 506(a) does not apply. Justice Thomas began his analysis by pointing out that it is "correct to look to Section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim," and doing so in *Nobelman*, he continued, showed that the mortgage holder, American Savings Bank, was "still the `holder' of a `secured claim,' because petitioner's home retains $23,500 of value as collateral." 508 U.S. at 329, 113 S.Ct. at 2110. Once it was clear that American Savings was a holder of a claim secured by the debtor's principal residence, Justice Thomas reasoned that Section 1322(b)(2) dictates that none of the bank's "rights" could be "modified" for its claim, even though

part of the bank's claim was deemed unsecured under Section 506(a). Finding that the term "rights" was not defined by the Bankruptcy Code, Justice Thomas invoked state law to determine the word's meaning and therefore concluded that, when the antimodification clause applies, it prevents the debtor's Chapter 13 plan from modifying the mortgage holder's state-law rights to repayment. What counts as impermissibly "modifying" a creditor's rights, however, should not be understood too broadly. Justice Thomas hastened to add that the mortgage holder's rights are still "affected" by the bankruptcy. The automatic stay, for example, still blocks the creditor's right to foreclose, and debtors can cure prepetition defaults on a home mortgage under Section 1322(b)(5). *See Nobelman*, 508 U.S. at 330, 113 S.Ct. at 2110.

The McDonalds argue that because *Nobelman* stated that Section 506(a) still applies and determines the "status" of a creditor's claim, it follows that a wholly unsecured mortgage is no longer a secured claim under the Bankruptcy Code and hence is not subject to the antimodification clause. *Nobelman* specifically said that the bank was a holder of a secured claim "because the petitioner's home retains $23,500 of value as collateral." 508 U.S. at 329, 113 S.Ct. at 2110. In the McDonalds' case they allege that there is no value left in their home as collateral for Master Financial's mortgage.

So far the only appellate panel to apply *Nobelman* to a wholly unsecured mortgage has agreed with the McDonalds that such a mortgage is not subject to the antimodification clause. *In re Lam*, 211 B.R. 36 (9th Cir. BAP), appeal dismissed, 192 F.3d 1309 (9th Cir. 1999). The many bankruptcy courts to consider the issue have split, with a majority favoring the McDonalds' view[2] but some adopting the opposing view.[3] Bankruptcy treatises are also divided on the

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[2] See, e.g., In re McCarron, 242 B.R. 479 (Bankr.W.D.Mo. 2000); *In re Johnson*, 226 B.R. 364 (D.Md. 1998); *In re Cerminaro*, 220 B.R. 518 (Bankr.N.D.N.Y. 1998); *In re Phillips*, 224 B.R. 871 (Bankr.W.D.Mich. 1998); *In re Reeves*, 221 B.R.756 (Bankr.C.D.Ill. 1998); *In re Smith*, 215 B.R. 716 (Bankr.W.D.Tenn. 1998); *In re Bivvins*, 216 B.R. 622 (Bankr.E.D.Tenn. 1997); *In re Scheuer*, 213 B.R. 415 (Bankr.N.D.N.Y. 1997); *In re Cervelli*, 213 B.R. 900 (Bankr.D.N.J. 1997); *In re Geyer*, 203 B.R. 726 (Bankr.S.D.Cal. 1996); *In re Sanders*, 202 B.R. 986 (Bankr.D.Neb. 1996); *In re Purdue*, 187 B.R. 188 (S.D.Ohio 1995); *Wright v. Commercial Credit Corp.*, 178 B.R. 703 (E.D.Va. 1995); *In re Thomas*, 177 B.R. 750 (Bankr.S.D.Ga. 1995); *In re Lee*, 177 B.R. 715 (Bankr.N.D.Ala. 1995); *In re Woodhouse*, 172 B.R. 1 (Bankr.D.R.I. 1994); *In re Sette*, 164 B.R. 453 (Bankr.E.D.N.Y. 1994); *In re Castellanos*, 178 B.R. 393 (Bankr.M.D.Pa. 1994); *In re Mitchell*, 177 B.R. 900 (Bankr.E.D.Mo. 1994); *In re Hornes*, 160 B.R. 709 (Bankr.D.Conn. 1993); *In re Plouffe*, 157 B.R. 198 (Bankr.D.Conn. 1993); *In re Lee*, 161 B.R. 271 (Bankr.W.D.Okla. 1993); *In re Moncrief*, 163 B.R. 492 (Bankr.E.D.Ky. 1993); *In re Kidd*, 161 B.R. 769 (Bankr.E.D.N.C. 1993); *In re Williams*, 161 B.R. 27 (Bankr. E.D.Ky. 1993).

[3] See, e.g., *In re Boehmer*, 240 B.R. 837 (Bankr.E.D.Pa. 1999); *In re Tanner*, 223 B.R. 379 (Bankr.M.D.Fla. 1998); *In re Lewandowski*, 219 B.R. 99 (Bankr.W.D.Pa. 1998); *In re Bauler*, 215 B.R. 628 (Bankr.D.N.M. 1997); *In re Mattson*, 210 B.R. 157 (Bankr.D.Minn. 1997); *In re Shandrew*, 210 B.R. 829 (Bankr.E.D.Cal. 1997); *In re*

issue. Compare 5 Collier on Bankruptcy, Section 1322.06[1][a] at 1322-16 ("If the creditor had held a lien on property that had no value (perhaps because the property was fully encumbered by prior liens), then under this analysis it would not have been a "holder of a secured claim" entitled to protection by section 1322(b)(2).") with Keith M. Lundin, Chapter 13 Bankruptcy 2d ed., Section 4.46 at 4-56 ("Although the concept of an "unsecured secured claim" is impossible under Section 506(a), Justice Thomas's focus on the "rights" of the "holders" of a "claim secured only by . . ." in Section 1322(b)(2) extends the protection from modification . . . without regard to the allowance or disallowance of secured claims under Section 506(a).").

While we acknowledge that there is some ambiguity in the language in *Nobelman*, we believe that the better interpretation is that reached by Collier's, the Ninth Circuit bankruptcy panel in *Lam*, and the majority of bankruptcy courts to consider the issue. The Supreme Court did not adopt the Fifth Circuit's view that Section 506(a) is inapplicable, and Section 103(a) provides that Section 506(a) does apply to a Chapter 13 bankruptcy. Once we accept that courts must

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Fraize, 208 B.R. 311 (Bankr.D.N.H. 1997); *In re Barnes*, 207 B.R. 588 (Bankr.N.D.Ill. 1997); *In re Neverla*, 194 B.R. 547 (Bankr.W.N.Y. 1996); *In re Barnes*, 199 B.R. 256 (Bankr.S.D.N.Y. 1996); *In re Jones*, 201 B.R. 371 (Bankr.D.N.J. 1996); *In re Witt*, 199 B.R. 890 (W.D.Va. 1996).

apply Section 506(a), then it follows, even under *Nobelman*, that a wholly unsecured mortgage holder does not have a secured claim. Justice Thomas specifically said that the bank in *Nobelman* had a secured claim "because" the bank's lien still attached to some existing value in the debtor's house. We do not think there is any meaningful sense in which a court could be said to apply Section 506(a) if the sole function of the section was simply to adopt the state-law label of the claim as secured. Moreover, if the value of the collateral were irrelevant, then it is hard to see why Justice Thomas would instruct that the debtors "were correct in looking to Section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim." *Nobelman*, 508 U.S. at 328, 113 S.Ct. at 2110. Courts hardly need to perform a valuation of the collateral to adopt the original state-law label of the claim as secured. The only reason there is any doubt about the result is Justice Thomas's discussion of the term "claim" occurring in the antimodification clause. When he rejected the approach of the courts holding that the antimodification clause applies only to the still secured part of a mortgage under Section 506(a), Justice Thomas said that those courts had incorrectly relied on the rule of the last antecedent. To see how that rule applies, recall that Section 1322(b)(2) states that a debtor's Chapter 13 plan can "modify the rights of holders of secured claims, other than a claim secured only by a security interest in . . . the debtor's principal residence . . . ." Under the rule of the last

antecedent, the clause "other than a claim secured only by a security interest in . . . the debtor's principal residence," modifies its immediate antecedent, "secured claims." With "secured claims" as the term modified, courts had reasoned before *Nobelman* that the antimodification clause must apply only to the part of a mortgage that remained a "secured claim." Justice Thomas agreed that this reading "is quite sensible as a matter of grammar," but concluded that the reading "is not compelled." *Nobelman*, 508 U.S. at 330, 113 S.Ct. at 2111.

He explained that the statute deliberately used the unmodified term "claim" in the antimodification clause, rather than the term "secured claim." Since "claim" receives a broad interpretation under the Bankruptcy Code, the term encompasses both the secured and unsecured portions of the mortgage, a conclusion showing that the antimodification clause applies to both parts of the mortgage.

This discussion of the term "claim" has created some confusion because earlier Justice Thomas emphasized that applying Section 506(a) in the case before the Court showed that, since value remained in the collateral, the bank was "still the `holder' of a `secured claim.' " Id. at 329, 113 S.Ct. at 2110. If his subsequent discussion concluded that the antimodification clause, by using the unmodified term "claim," applied to both the unsecured and secured part of the mortgage, then why did he bother to establish earlier that the bank

was still a holder of a secured claim? Doesn't the expansive reading of the term "claim" make it irrelevant whether the bank remains a holder of a secured claim? We think the Supreme Court's discussion of Sections 506(a) and 1322(b)(2) is consistent. Perhaps the clearest explanation of how the Court's discussion of the two sections can be reconciled is to point out that while the antimodification clause uses the term "claim" rather than "secured claim" and therefore applies to both the secured and unsecured part of a mortgage, the antimodification clause still states that the claim must be "secured only by a security interest in . . . the debtor's principal residence." 11 U.S.C. Section 1322(b)(2) (emphasis added). If a mortgage holder's claim is wholly unsecured, then after the valuation that Justice Thomas said that debtors could seek under Section 506(a), the bank is not in any respect a holder of a claim secured by the debtor's residence. The bank simply has an unsecured claim and the antimodification clause does not apply. On the other hand, if any part of the bank's claim is secured, then, under Justice Thomas's interpretation of the term "claim," the entire claim, both secured and unsecured parts, cannot be modified. We think this reading reconciles the various parts of the Court's opinion.[4]

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[4] Master Financial asserts in its brief that wholly unsecured mortgages are regularly bought and sold, and therefore a wholly unsecured mortgage has value and is still subject to the antimodification clause. Whatever value a wholly unsecured mortgage might have in the market Master Financial has in

Master Financial insists that the Supreme Court's statement that Section 506(a) still applies is dictum and should be ignored. We disagree. Chief Judge Posner has aptly defined dictum as "a statement in a judicial opinion that could have been deleted without seriously impairing the analytical foundations of the holding--that, being peripheral, may not have received the full and careful consideration of the court that uttered it." *Sarnoff v. American Home Prods. Corp.*, 798 F.2d 1075, 1084 (7th Cir. 1986). Justice Thomas's statement that it is correct to apply Section 506(a) is critical to *Nobelman's* holding, for if the petitioner's home had not retained some value as collateral, the Supreme Court's discussion of Section 506(a) implies that the result would have been different. The Supreme Court's discussion is only dictum, in other words, if you assume Master Financial's reading of the case is correct at the outset.

The bare fact that the Supreme Court was not considering a wholly unsecured mortgage does not convert into dicta every piece of reasoning in *Nobelman* bearing on that issue. A holding, as *Sarnoff's* definition makes clear, extends beyond a

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mind, that value has no bearing on the inquiry under Section 506(a). Section 506(a) compares the value of the collateral against the "creditor's interest in the estate's interest in [the collateral]." Master Financial's position would only make sense if the creditor was entitled to collect from the debtor not only the money owed on the debt but also the price that the mortgage might be sold to someone else.

statement of who won or lost a case. A court can choose among different holdings that offer broader or narrower ways of resolving a dispute. It is also worth emphasizing that the Supreme Court's discussion of Section 506(a) was not likely to have been an ill-considered remark since the Fifth Circuit opinion that the Supreme Court reviewed expressly rejected that Section 506(a) applies. *See In re Nobelman*, 968 F.2d 489, 488 (5th Cir. 1992). Furthermore, on Master Financial's interpretation the Supreme Court's discussion of Section 506(a) is not dictum in the sense that it resolved a real legal issue, but one that could be readily deleted from the court's rationale for deciding the case; rather, Master Financial's view makes the Court's discussion of Section 506(a) a useless aside that could not be relevant to any case involving the antimodification clause.

But even if the discussion of Section 506(a) could be accurately characterized as dictum--and we think it cannot be—we should not idly ignore considered statements the Supreme Court makes in dicta. The Supreme Court uses dicta to help control and influence the many issues it cannot decide because of its limited docket. "Appellate courts that dismiss these expressions [in dicta] and strike off on their own increase the disparity among tribunals (for other judges are likely to follow the Supreme Court's marching orders) and frustrate the evenhanded administration of justice by giving litigants an outcome other than the one the Supreme Court would

be likely to reach were the case heard there." *United States v. Bloom*, 149 F.3d 649, 653 (7th Cir. 1998).

We think the textual arguments about *Nobelman* by themselves require the result we reach today, but we also are unpersuaded by Master Financial's policy arguments that the Supreme Court reached the wrong result. The first point to stress is that, as Justice Stevens noted in his concurrence, the antimodification clause's legislative history shows that the provision's "favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market." 508 U.S. at 332, 113 S.Ct. 2112. Because second mortgages are rarely used to purchase a home, making wholly unsecured second mortgages subject to the antimodification clause would have at best a minimal impact in encouraging home building and buying. The holder of a second mortgage is apt to be very much like other general creditors, and therefore it seems reasonable that a wholly unsecured second mortgage will be subject to the same rules that apply to other secured claims--i.e., a claim not secured by any current value in the specified collateral is deemed an unsecured claim.

One often-cited concern that Master Financial invokes is that it would be unjust and arbitrary to allow a mortgage holder to have an unmodifiable claim when there is merely one dollar of value left in the residence, but leave a mortgage holder with a modifiable (and hence potentially valueless) claim if

there is no remaining value in the residence. We will begin with the complaint that the result is arbitrary and then turn to the objection that it is unjust. Bright-line rules that use a seemingly arbitrary cut-off point are common in the law. A day beyond the statute of limitations and the plaintiff must lose, even if the claim was otherwise unquestionably a winning one. If the evidence is just over a preponderance, the plaintiff wins full damages; just under, the plaintiff gets nothing. In bankruptcy law a Chapter 7 trustee cannot contest the validity of a debtor's claimed exemption when the 30-day period for objecting has expired and the trustee failed to obtain an extension; and this is true even if the debtor has no colorable basis for claiming the exemption. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644 (1992). To take an example closer to our case, we have read the word "only" in the antimodification clause's phrase, "secured only by a security interest in . . . the debtor's principal residence," to mean that the clause's protection is unavailable when the loan is secured not just by the debtor's residence but by other property as well. *See, e.g., Hammond v. Commonwealth Mortgage Co.*, 27 F.3d 52 (3d Cir. 1994); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 126-29 (3d Cir. 1990). What these examples show is that line drawing is often required in the law and, at the boundary, the appearance of unfairness is unavoidable. Simply pointing out that some arbitrariness occurs is not a compelling objection. Master Financial believes that the law should always prevent the modification of a

mortgage in a Chapter 13 bankruptcy and hence the law should not require a distinction between a wholly unsecured and a partially secured mortgage. This is essentially the argument that the result is unjust. As we have explained, there is no way to reconcile Master Financial's position with the reasoning in Justice Thomas's opinion. Even if we agreed with Master Financial's argument that the result is unjust, we would be bound. But in any event, holders of second mortgages are in a sense unintended beneficiaries of congressional intent to boost the home-buying and home-building markets. And to the extent there is any unfairness in the distinction between wholly unsecured mortgage holders and those secured only by a nominal value, the creditor with only a dollar's worth of security in the property cannot be heard to complain--such a creditor can invoke the antimodification clause. Any unfairness in that circumstance falls on the debtor. The only class of creditors who can complain are those who are wholly unsecured, but as we set forth above, these creditors are not worse off than other secured creditors who operate outside of mortgage lending.

We also note that our holding frequently will not make holders of wholly unsecured residential mortgages worse off than they would be under Master Financial's own rule making a wholly unsecured residential mortgage unmodifiable. This is true because a debtor who has outstanding balances on multiple mortgages exceeding the current value of

the debtor's home often will not try to keep a home encumbered with so much debt, and instead will turn to a Chapter 7 bankruptcy and allow the home to be sold in liquidation. For example, consider that in our case Master Financial's reading of *Nobelman* would have the McDonalds pay, according to the McDonalds' statement of the facts, $174,479.75 to keep a home worth $126,400. A rational debtor might well decide to switch to Chapter 7, lose the home, and start over. Once the debtor proceeds under Chapter 7, a holder of a wholly unsecured mortgage will again, under Section 506(a), be deemed unsecured and receive no more (and possibly less) money than that creditor would have under our interpretation of the antimodification clause. *See* 11 U.S.C. Section 1325 (providing requirements for a Chapter 13 plan's payment of unsecured creditors).

We also think it is significant that courts have repeatedly emphasized Congress's preference that individual debtors use Chapter 13 instead of Chapter 7. Part of the reason for this preference is that unsecured creditors often receive more money under successful Chapter 13 plans than they would under a Chapter 7 liquidation bankruptcy. To the extent Master Financial's rule would stampede more debtors into Chapter 7, Master Financial's strong interpretation of the antimodification clause would pursue the tenuous gains for holders of wholly unsecured mortgages by imposing losses on other

unsecured creditors who will be worse off in Chapter 7 than they would have been in Chapter 13.

Master Financial responds that Chapter 7 will not offer a viable alternative for debtors because the Supreme Court has rejected lien-stripping in Chapter 7. *See Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773 (1992). It is true that in *Dewsnup* the Supreme Court concluded that a debtor in Chapter 7 could not use Section 506(d) to " `strip down' a creditor's lien on real property to the value of the collateral, as judicially determined, when that value is less than the amount of the claim secured by the lien." *Id.* at 412, 112 S.Ct. at 775. The Court reached this conclusion to prevent debtors from benefiting from any increase in the value of their home between the time its value was judicially determined (and hence the time part of the debt was deemed unsecured) to the time of the later foreclosure sale. For example, before *Dewsnup* if the outstanding balance on the mortgage was $120,000, the house was judicially valued at $100,000, and the house's value later rose to $130,000 by the foreclosure sale, the debtor could strip down the lien to $100,000 and later take the $30,000 increase free of the creditor's claim to the $20,000. Because *Dewsnup* allowed the creditor in Chapter 7 to maintain a claim against the property for the unsecured balance, the decision prevented a Chapter 7 debtor from benefiting from an increase in the value of the home. But what matters for our purposes is that even under *Dewsnup* the debtor is still discharged of personal

liability, so *Dewsnup* does not eliminate the incentive to switch from Chapter 13 to 7 in order to escape debt on a home that far exceeds the home's value. A debtor in the McDonalds' position would still view Chapter 7 as a better alternative than Chapter 13. It is also worth noting that courts are split on whether *Dewsnup's* rejection of lien-stripping in Chapter 7 applies to a wholly unsecured lien, although of course we express no view on that dispute. Compare *In re Yi*, 219 B.R. 394 (E.D.Va. 1998), and *Howard v. National Westminister Bank*, 184 B.R. 644 (Bankr.E.D.N.Y. 1995), with *In re Laskin*, 222 B.R. 872 (9th Cir. BAP 1998).

One last point should be mentioned. This appeal does not require us to decide what date a court should use to determine whether a mortgage is wholly unsecured. The parties appear to have assumed that the date the adversary proceeding was initiated should be used. There is no clear consensus in the caselaw. Compare *In re McCarron*, 242 B.R. 479, 482 (Bankr.W.D.Mo. 2000)(using the date the bankruptcy petition was filed) with *In re Crain*, 243 B.R. 75 (Bankr.C.D.Calif. 1999)(using the effective date of the Chapter 13 debtor's plan or ten days after the order confirming the plan if no timely appeal has been made). Section 506(a) states, "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." Although we need not resolve the

issue, we point out that whatever rule is adopted, it is desirable to avoid allowing an appeal to delay the date used for evaluation. Such a rule could encourage the losing party to bring an appeal in the hope of obtaining a more favorable evaluation.

For the foregoing reasons, we hold that a wholly unsecured mortgage is not subject to the antimodification clause in Section 1322(b)(2). The judgment of the District Court will be reversed. The case will be remanded to the District Court for it to remand the matter to the Bankruptcy Court for further proceedings consistent with this opinion. Costs taxed against appellee.

Clerk of the United States Court of Appeals.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	CIVIL ACTION
	:	
STEPHEN J.	:	
McDONALD and	:	Bankruptcy No. 97-34745
ROSEMARIE J.	:	
McDONALD,	:	Chapter 13
	:	
Appellant	:	FILED APR - 9 1999
	:	
v.	:	ADVERSARY NO. 98-0189
	:	
MASTER	:	
FINANCIAL, INC.	:	
FREDERICK L.	:	
RIEGLE, Trustee,	:	NO. 99-cv-149
	:	
Appellee	:	

ORDER

AND NOW, this 9th day of April, 1999, upon consideration of Appellants' Brief on Appeal from Memorandum Opinion and Order of United States Bankruptcy Court, and Appellee's Brief thereto, it is hereby ORDERED that the order from the bankruptcy court is AFFIRMED.

BY THE COURT:
/s/ James T. Giles
JAMES T. GILES, C.J.

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to

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	CIVIL ACTION
	:	
STEPHEN J.	:	
McDONALD and	:	Bankruptcy No. 97-34745
ROSEMARIE J.	:	
McDONALD,	:	Chapter 13
Appellant	:	
	:	
v.	:	ADVERSARY NO. 98-0189
	:	
MASTER	:	
FINANCIAL, INC.	:	
FREDERICK L.	:	
REIGLE, Trustee,	:	NO. 99-cv-149
	:	
Appellee	:	

OPINION

GILES, C.J. April 9th, 1999

The court has before it an appeal filed by Stephen and Rosemarie McDonald ("Appellants"). The United States Bankruptcy Court for the Eastern District of Pennsylvania held that Appellants may not modify the second mortgage on their residence despite the fact that the second mortgage may not be secured by value in the property. For the reasons stated within, the bankruptcy court's order is affirmed.

Facts

Appellants purchased their home in August, 1995. They financed the purchase with a mortgage loan from BancPlus Mortgage Corporation ("Banc") for the original amount of $128,937.00. In September 1996, Appellants were granted a second mortgage loan from Baltimore American Mortgage Corporation ("Baltimore") in the amount of $45,850.00. Thereafter, Baltimore assigned the full amount of the second mortgage to Master Financial, Inc. ("Appellee"). On December 3, 1997, Appellants filed a Chapter 13 bankruptcy petition. Appellants then filed an adversary proceeding, seeking to remove Appellee's second mortgage.

Appellants contend that because the amount of the second mortgage exceeds the fair market value of their residence, the second mortgage should be "stripped" and treated entirely as an unsecured claim.[1] Appellee avers that the bankruptcy court was correct in treating the second mortgage as a secured claim by not allowing a bifurcation of the claims pursuant to 11 U. S. C. A. § 506. The primary issue for this court to decide is whether the bankruptcy was correct in holding that the Appellants may not modify the second mortgage on their residence despite the fact that the second mortgage may not be secured by value in that property.

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[1] In the adversary, Appellants allege the fair market value of the property is $126,400.00, the balance of the first mortgage is $127,633.33 and the amount of the second mortgage is $46,846.42. Appellee disputes the fair market value alleged by the Appellant but concedes its loan is undersecured.

Jurisdiction

This court has jurisdiction of all cases that arise under Title 11 pursuant to 28 U.S.C. § 1334(a). The statute which governs jurisdiction on appeal from the bankruptcy court is 28 U.S.C.A. § 158(a). Section 158 states in relevant part:

> (a) The district courts of the United States shall have jurisdiction to hear appeals, from final judgments, orders, and decrees ... of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title ...

28 U.S.C.A. § 158(a).

Standard of Review

In cases originating in the bankruptcy court, this court occupies the first level of appellate review. The court will apply a clearly erroneous standard to findings of fact and a *de novo* standard of review to questions of law. *In re Berkery*, 193 B.R. 835, 837 (E.D. Pa. 1995), aff'd, 111 F.3d 125 (3d Cir. 1996)(citing *In re Molded Acoustical Prod., Inc.*, 150 B.R. 608, 612 (E.D. P.a. 1993).

Discussion

This appeal concerns the interpretation and interaction of two provisions of the Bankruptcy Code: § 506(a). In essence, the creditor's claim is converted to secured debt up to the fair market value of the property and unsecured debt as to the remainder. *See*

In re Bender, 86 B.R. 809, 811 (Bankr. E.D. Pa. 1988)(discussing § 506(a)).

Section 1322(b)(2), provides in relevant part:

> [T]he plan may ... modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C.A. § 1322(b)(2). This section, which limits a party's ability to modify the rights of a lien on real property that is a debtor's principal place of residence, is known as the 'anti-modification' provision. *In re Hammond*, 27 F.3d 52, 54 (3d Cir. 1994). The question that presents itself when considering § 506(a) and § 1322(b)(2) together is whether § 1322(b)(2) prevents a Chapter 13 debtor from relying on § 506(a) to modify the unsecured portion of an undersecured mortgage claim, or whether the debtor is entitled to bifurcate ~ecured claim pursuant to § 506(a). *Id.*

The crux of this opinion will rest on an interpretation of the United States Supreme Court decision *Nobelman v. American Savings Bank*, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d 228 (1993). In *Nobelman*, the debtors had a first mortgage on their residence of approximately $71,000.00 while the

parties stipulated that the fair market value of the residence was only $23,500. Debtors proposed to make payments on the mortgage only up to the fair market value of the residence and treated the remainder of the claim as unsecured. The creditor objected, contending that bifurcating the claim into secured and unsecured claims would violate § 1322(b)(2). Debtor asserted that the protection of § 1322(b)(2) applies only to the extent that the creditor held a secured claim in the residence. *See American Gen. Fin. v. Dickerson*, 229 B.R. 539 (M.D. Ga. 1999)(debtors could not "strip off" lien of junior mortgagee, as creditor whose claim was secured solely by interest in real property that was debtors' principal residence, though value of mortgage property was less than amount of senior mortgage debt).

The Court held that the bifurcation of a home mortgage into secured and unsecured portions, and modification of the unsecured deficiency claim, is not permitted in a Chapter 13 case with respect to a mortgage on only the debtor's principal residence. *Nobelman*, 508 U.S. at 332.

Since *Nobelman* was decided, courts have been split as to whether § 1322(b)(2) bars a Chapter 13 plan from modifying the rights of holders of claims secured only by the debtor's principal residence, applies only to holders of totally unsecured claims. The majority view is that when a mortgage is completely secured, the lien can be entirely "stripped" and § 1322(b)(2) does not apply. Although

Nobelman was decided based on the rights of the holder of the secured claim under § 1322(b)(2), courts supporting the view that a wholly unsecured lien can be "stripped" off focus on valuation under § 506(a) of the collateral securing the lien. *In re Lewandowski*, 219 B.R. 99, 103 (W.D. Pa. 1998). These courts view *Nobelman* as limited to situations in which the claim is at least partially secured. *See e.g., In re Lam*, 211 B.R. 36 (9th Cir. BAP 1997); *In re Cervilli*, 213 B.R. 900 (Bankr. D.N.J. 1997); *Wright v. Commercial Credit Corp.*, 178 B.R. 703 (E.D. Va. 1995), appeal dismissed 77 F.3d 472 (4th Cir. 1996); *In re Thomas*, 177 B.R. 750 (Bankr. S.D. Ga. 1995); *Matter of Plouffe*, 157 B.R. 198 (Bankr. D. Conn. 1993).

The minority insist that *Nobelman* forbids "stripping" down a lien represented by residential mortgages, even when the claim is wholly unsecured. *See e.g., In re Barnes*, 207 B.R. 588 (Bankr. N.D. I11. 1997); *In re Shandrew*, 210 B.R. 829 (Bankr. E.D. Cal. 1997); *In re Neverla*, 194 B.R. 547 (Bankr. W.D. N.Y. 1996); *In re Jones*, 201 B.R. 371 (Bankr. D.N.J. 1996); *In re Fraize*, 208 B.R. 311 (Bankr. D.N.H. 1997).

Before the *Nobelman* decision, the third circuit was bound by *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990) and *Sapos v. Provident Inst. of Sav.*, 967 F.2d 918 (3d Cir. 1991). In *Wilson* and *Sapos*, the third circuit considered the interplay between § 506(a) and § 1322(b)(2). In both, the courts held that § 1322(b)(2) does not prohibit modification of the unsecured component of an undersecured mortgage. *See Sapos*, 967 F.2d at 926; *Wilson*, 895 F.2d at 127-28.

Additionally, the courts noted that § 1322(b)(2)'s anti-modification clause does not apply when the creditor has *an additional security interest in collateral other than the real property in which the debtor resides. See Sapos,* 967 F.2d at 925; *Wilson,* 895 F.2d at 128 (emphasis added). Section 1322(b)(2)'s express terms cover claims secured only by a security interest in the debtor's principal residence. *See Sapos,* 967 F.2d at 926; *Wilson,* 895 F.2d at 128.

After *Nobelman,* the third circuit continued to follow *Sapos* and *Wilson* the decision of *In re, Hammond,* 27 F.3d 52 (3d Cir. 1994). In *Hammond,* debtors purchased a home and financed it with a loan from Jersey Mortgage Company, which was then assigned to Commonwealth Mortgage Corporation of America ("Commonwealth"). *Hammond,* 27 F.3d at 53. The assignment made Commonwealth also possessed a security interest in "any and all appliances, machinery, furniture and equipment (whether fixtures or not) of any nature whatsoever now or hereafter installed in or upon said premises ..." *Id.* At 53-54. Commonwealth eventually foreclosed on the mortgage and debtors filed a Chapter 13 bankruptcy petition. *Id.* at 54. Debtors thereafter filed an adversary proceeding, seeking to limit Commonwealth's allowed secured claim to the fair market value of their home.[2] *Id.*

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[2] Commonwealth obtained a foreclosure judgment for $30,726.10 and filed a secured claim for $42,969.93. The parties stipulated that the fair market value of the debtors home was $25,000.00.

The third circuit held that a mortgage which creates security interests in a debtor's personal property in addition to a lien on the mortgagor's principal residence takes the mortgage beyond the protection of the anti-modification of § 1322(b)(2). *Hammond,* 27 F.3d at 58. Additionally, § 1322 (b)(2) permits bifurcation of the mortgage into secured and unsecured components under § 506(a). *Id.*

The Supreme Court's decision in *Nobelman* only overruled one of the two rationales used in *Sapos, Wilson* , and *Hammond.* These third circuit decisions allow for a bifurcation under § 506(a) when the mortgagee has an additional security in property other than the mortgagors' primary residence. Furthermore, the fifth circuit and Supreme Court never addressed that particular issue in *Nobelman.* The third circuit points out that the alternate rationale applied in *Sapos, Wilson,* and *Hammond* is controlling. This court follows the third circuit's rationale. However, this Court recognizes that the present action is factually different from *Sapos, Wilson,* and *Hammond.* Here, Appellee's mortgage is not secured by any collateral other than Appellant's principal residence.[3]

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[3]The third circuit does acknowledge that § 1322(b)(2)'s clear language reflects a congressional policy meant to protect home mortgage lenders. However, based on the facts in *Sapos, Wilson,* and *Hammond,* the third circuit was unable to read the statutory text of § 1322(b)(2) to include mortgages which are secured not only by a "principal residence" but also by "appliances, machinery, furniture, and equipment of any nature whatsoever." *See Hammond* 27 F.3d at 57.

Therefore, this court will focus on *Nobleman's* holding which expressly overruled *Wilson* and *Sapos* that "Section 1322 (b)(2) does not preclude a debtor from modifying the undersecured portion of a mortgage." *see Hammond* 27 F.3d at 56. The Supreme Court stated: "Section 1322(b)(2) prohibits such a modification where, as here, the lender's claim is secured only by a lien on the debtor's principal residence." *Id.* (quoting *Nobleman* 508 U.S. at 322).

Appellants attempt to differentiate between *Nobelman* and the present action. In *Nobelman* the mortgage held by the creditor was partly secured by the fair market value in the debtors' principal residence and was only partly unsecured for the portion exceeding the fair market value. It is alleged here that the principal residence has a fair market value less than the senior mortgage. Thus, Appellants urge the court to treat Appellee as completely unsecured and only afford him the rights of an unsecured creditor.

Congress chose to use the phrase "claim secured ... by" in § 1322(b)(2)'s exception, rather than repeating the term of art "secured claim." *Nobelman*, 508 U.S. at 331. The unqualified word "claim" is broadly defined under the Code to encompass any "right to payment, whether ... secure[d] or unsecured" or any "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether ... secure[d] or unsecured." *Id.* The plain language supports the finding that even though Appellee's claim is

unsecured on Appellants' principal residence, Appellants are forbidden from modification. The term "secured claim" is not used throughout the Bankruptcy Code, but the draftsmen in this instance chose not to use it. *See In re Fraize*, 208 B.R. 311 (D.N.H. 1997)(Chapter 13 plan could not modify second mortgagee's claim, even though second mortgage on debtors' principal residence was wholly unsecured).

The bankruptcy court below correctly concluded that the "rights" of an undersecured mortgage holder attaching only to debtor's residence may not be modified if liquidation at market would provide some value to the holder. Bankr. Op. at 3. It is clear that if $1 of a second mortgage were secured by collateral value, *Nobelman* would apply. At least $1 of the claim would be a secured claim. *Id.* In effect, the "rights" of the holder of a secured claim could not be modified. However, if the claim was $1 less than the second mortgage would hold a zero claim secured under § 506 and not be protected under § 1322(b)(2). This places too great a significance on the value of the residential property, produces arbitrary and unjust results, undermines the importance of protecting residential mortgages, and is contrary to the language of § 1322(b)(2).

Moreover, this holding is consistent with "legislative history indicating that favorable treatment of residential mortgages was intended to encourage the flow of capital into the home lending market." *Nobelman*, 508 U.S. at 332 (Stevens, J.,

concurring). This language emphasizes that Congress intended for § 1322(b)(2) to prevail over § 506(a) with respect to residential mortgages.

Conclusion

For the reasons stated above, the order of the bankruptcy court is AFFIRMED.

BY THE COURT:

/s/ James T. Giles
JAMES T. GILES, C.J.

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APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	)
	)
STEPHEN J. McDONALD and ROSEMARIE J. McDONALD,	) Bankruptcy No. 97-34745
	) Chapter 13
Debtors,	)
	)
STEPHEN J. McDONALD and ROSEMARIE J. McDONALD,	) Adversary No. 98-0189
Plaintiffs,	)
vs.	)
MASTER FINANCIAL, INC., and FREDERICK L. RIEGLE, Trustee,	)
Defendants.	)

ORDER OF COURT

AND NOW, this 3 day of December, 1998, upon the basis of the attached Memorandum Opinion of this date herewith, IT IS ORDERED, ADJUDGED

and DECREED that the debtor's complaint is denied.

/s/ Joseph L. Cosetti
Joseph L. Cosetti
U. S. Bankruptcy Judge

cc: Alisa R. Hobart, Esq.
Joseph A. Diorio, Esq.

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	)	
	)	
STEPHEN J. McDONALD	)	Bankruptcy No. 97-34745
And ROSEMARIE J.	)	
McDONALD,	)	Chapter 13
	)	
Debtors,	)	
	)	
STEPHEN J. McDONALD	)	
And	)	Adversary No. 98-0189
ROSEMARIE J.	)	
McDONALD,	)	
	)	
Plaintiffs,	)	
	)	
vs.	)	
	)	
MASTER FINANCIAL,	)	
INC., and FREDERICK L.	)	
RIEGLE, Trustee,	)	
	)	
Defendants.	)	

MEMORANDUM OPINION

The matter before the court is whether the Chapter 13 debtors may modify a second mortgage lien on their principal residence. For the reasons expressed below, the court finds that debtors may not

modify the second mortgage on their residence despite the fact that the second mortgage may not be secured by value in the property.

Facts

Debtors filed their voluntary Chapter 13 petition on December 3, 1997. Prior to filing, debtors purchased their residence in August of 1995. A first mortgage was granted to BancPlus Mortgage Corp. in the original amount of $128,937.00. In September of 1996, debtors granted a second mortgage to Baltimore American Mortgage Corp. in the amount of $45,850.00 which was assigned to defendant Master Financial, Inc.

Debtors filed the above-captioned adversary on March 30, 1998 seeking to have the claim of Master Financial disallowed as a secured claim and treated entirely as an unsecured claim. In the adversary, plaintiffs/debtors allege that the value of the property is $126,400.00, the balance of the first mortgage is $127,633.33 and the amount of the second mortgage is $46,846.42. Master Financial disputes the fair market value alleged by the debtors. No evidentiary hearing has been held to determine the amounts.

Analysis

This case focuses on the relationship of two provisions of the Bankruptcy Code, 11 U. S. C. § 1322 (b) and § 506 (a), and the U. S. Supreme Court's

decision which interprets those provisions, *Nobleman v. American Sav. Bank*, 113 S. Ct. 2106 (1993).

When the Supreme Court decided the *Nobleman* opinion, it recognized that "it was permissible to seek a valuation . . . But even if we accept petitioner's valuation, the bank is still the 'holder' of a "secured claim" because petitioner's home retains $23,500 of value as collateral." 113 S. Ct. At 2110. It goes on to opine that the "rights" the bank enjoys are protected by 11 U. S. C. § 1322 (b) (2). *Nobleman* distinguishes the mortgagee's common law or state "rights" such as foreclosure, retention of lien, etc., from the Bankruptcy Code's definition of a claim during the claim's valuation process. *Id.* The *Nobleman* opinion concentrates on the "rights of holders" of claims with security interest in the debtor's principal residence.

Before *Nobleman*, courts of the Third Circuit were bound by *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990) and *Sapos v. Provident Inst. of Sav.*, 967 F.2d 918 (3d Cir. 1992). One of the reasons for granting certiorari in *Nobleman* was to resolve conflict among the Courts of Appeal. Four Circuits, the Second, Third, Ninth and Tenth, permitted bifurcation of homestead mortgages into a secured claim and an unsecured claim. These Courts of Appeal examined the statute and applied a "rule of the last antecedent" to the grammar of those sentences.

After *Nobleman*, it is clear that the "rights" of an *under secured* mortgage holder attaching only to

debtor's residence may not be modified if liquidation at market would provide some value to the holder. It is clear that if $1 on a second or junior mortgage were secured by collateral value, *Nobleman* would apply, because at least $1 of the claim would be a secured claim. The "rights" of the holder of a secured claim could not be modified.

However, the discussion later in the *Nobleman* opinion develops a further reason:

> Petitioners urge us to apply the so-called "rule of the last antecedent," which has been relied upon by some Courts of Appeals to interpret § 1322 (b) (2) the way petitioners favor. E.G., *In re Bellamy*, 962 F.2d 176, 180 (CA2 1992); *In re Hougland*, 886 F.2d 1182, 1184 (CA9 1989). According to this argument, the operative clause "other than a claim secured only by a security interest in . . . the debtor's principal residence" must be read to refer to and modify its immediate antecedent, "secured claims." Thus, § 1322 (b) (2)'s protection would then apply only to that subset of allowed "secured claims," determined by application of § 506 (a), that are secured by a lien on the debtor's home – including, with respect to the mortgage involved here, the bank's secured claim for $23,500. We acknowledge that this reading of the clause is quite sensible as a matter of grammar. But it is not compelled. Congress chose to use the phrase "claim secured . . . by" in § 1322 (b) (2)'s exception, rather than

> repeating the term of art "secured claim." The unqualified word "claim" is broadly defined under the Code to encompass any "right to payment, whether . . . secure[d] or unsecured" or any "rights to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether . . . secured[d] or unsecured." 11 U. S. C. § 101 (5) (1988 ed., Supp. III). It is also plausible, therefore, to read "a claim secured only by a [homestead lien]" as referring to the lienholder's entire claim, including both the secured and the unsecured components of the claim. Indeed, § 506 (a) itself uses the phrase "claim . . . secured by a lien" to encompass both portions of an undersecured claim.

113 S. Ct. at 2111.

Here Justice Thomas teaches us that modification of only that portion of the claim that is unsecured by the value of the collateral may be sensible as a matter of grammar, but is not reasonable and fails to focus on rights of holders. He decided that 11 U. S. C. § 1322 (b) (2) excludes from modification the "rights" of holders of consensual liens in the real property that is the debtor's principal residence whether or not it is secured by value. He finds that to be the reasonable reading of the statute.

The question presented by this case is if the valuation action under 11 U.S.C. § 506 (a) determines that the collateral's present market value is not adequate to pay any part of a junior lien, does the *Nobleman* rational apply? Chapter 13 debtor plans

may modify the holders of secured claims (the code defines a secured claim as a "lien created by an agreement," 11 U. S. C. § 101), but not if it is a claim secured only by a security interest in real property that is the debtor's principal residence.

The policy which Congress was attempting to vindicate was in response to lobbying by mortgage lenders for the continuing availability of home mortgage money for future home owners. We are not called to determine, based upon sound laws of economic analysis, if the policy Congress was attempting to vindicate would be successful or wise based on this limitation. Limiting bifurcation will not easily provide banks holding these undersecured or unsecured claims with the payment of money from Chapter 13 debtors. These limitations will not assist in the payment of loans granted improvidently. In fact, when debtors are unable to readily pay, 11 U.S.C. § 1322 (b) provisions are likely to increase debtor's choice of Chapter 7 over Chapter 13 in order to discharge debtor's personal obligations. However, I have been appointed to the office of a bankruptcy judge, not an economic judgeship.

The economic distribution to be received by the partially or totally unsecured claims is not the issue here. After *Nobleman*, mortgages on collateral completely unable to support payment of a secured claim continues to have rights such as foreclosure, etc. Bifurcation would modify the "rights" of such holders of claims which are protected by liens created by agreement.

Conclusion

As a judge trying to be faithful to the statute as explicated by the cases, principally *Nobleman*, I find that rights of holders of a debtor's residential mortgage are modified by bifurcation of the claim using 11 U. S. C. § 506 (a), even if the collateral is unable to pay any part of the claim. Accordingly, debtor's complaint shall be denied.

I recognize that the trial courts have split on these issues and that many courts have agreed and disagreed. An appellate decision would be useful.

An appropriate Order follows.

Dated this 3 day of December, 1998

/s/ Joseph L. Cosetti
Joseph L. Cosetti
U. S. Bankruptcy Judge

cc: Alisa R. Hobart, Esq.
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